

**Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 1655, *Returns, Defects and Replacements***

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

General Background

The Song-Beverly Consumer Warranty Act (commencing with Civ. Code, § 1790) contains provisions that provide warranty protections to purchasers of both new and used consumer goods. The act includes provisions (Civ. Code, §§ 1793.2 - 1793.26) that require compensation to California consumers of defective new motor vehicles – provisions commonly referred to as California’s “Lemon Law.” As relevant here, the Lemon Law provides that if the manufacturer or its representative is unable to service or repair a new motor vehicle to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer shall either promptly replace the new motor vehicle or promptly make restitution to the buyer. (Civ. Code, § 1793.2, subd. (d)(2).)

Under the existing Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), a lease of tangible personal property, including a lease of a motor vehicle, is, with exceptions not relevant here, a “sale” and a “purchase.” (Rev. & Tax. Code, §§ 6006, 6010.) For a lease that is a “sale” and a “purchase,” the tax is measured by the rentals payable. However, as provided in subdivision (c)(1) of California Code of Regulations, title 18, section (Regulation) 1660, *Leases of Tangible Personal Property – In General*, the applicable tax is generally use tax, not sales tax, and the lessor is required to collect the use tax from the lessee at the time the amount of rent is paid and give him or her a receipt as prescribed in Regulation 1686, *Receipts for Tax Paid to Retailers*. The lessee is not relieved from liability for the tax until he or she is given such a receipt or the tax is paid to the state.

The Lemon Law originally provided that in the case of restitution, a manufacturer was required to make restitution in an amount equal to the actual price paid or payable by the buyer, including, among other collateral charges, *sales tax*. (Civ. Code, § 1793.2.) The Lemon Law further required the State Board of Equalization (Board) to reimburse the manufacturer for an amount equal to the *sales tax* which the manufacturer paid to or for a buyer when providing a replacement vehicle or included in making restitution to the buyer when satisfactory proof was provided that:

- The retailer of the motor vehicle for which the manufacturer was making restitution had reported and paid the sales tax on the gross receipts from the sale of that motor vehicle; and
- The manufacturer complied with Civil Code section 1793.23, subdivision (c), which pertains to inscribing the ownership certificate of a reacquired vehicle with the notation

“Lemon Law Buyback” and affixing a decal to the vehicle regarding the notation on the ownership certificate. (Civ. Code, § 1793.25.)

However, the Lemon Law was silent with respect to whether restitution was required to include *use* tax and whether the Board was required to reimburse a manufacturer for use tax paid to or for a buyer or lessee or included in restitution paid to a buyer or lessee.

Assembly Bill No. 242 (AB 242) (Stats. 2011, ch. 727, §§ 1 and 2) amended the Lemon Law, specifically Civil Code sections 1793.2 and 1793.25, to make technical corrections sponsored by the Board. The amendments clarify that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer, including a lessee, of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to the Lemon Law. And, AB 242 provides that the Board-sponsored amendments to the Lemon Law are declaratory of existing law. (AB 242, § 21.)

Civil Code section 1793.2

With respect to Civil Code section 1793.2, AB 242 specifically:

- Amended subdivision (d)(2)(B) to add “use tax” to the collateral charges which a buyer is entitled to receive in cases of restitution; and
- Added subdivision (d)(2)(D) to specify that “[p]ursuant to section 1795.4, a buyer of a new motor vehicle shall also include a lessee of a new motor vehicle.”

Therefore, in the case of restitution, Civil Code section 1793.2, subdivision (d)(2)(B) and (D), currently provides, in relevant part, that the manufacturer shall make restitution in an amount equal to the actual price paid or payable by the buyer or lessee, including any collateral charges such as “sales or use tax.”

Civil Code section 1793.25

With respect to Civil Code section 1793.25 and as relevant here, AB 242 specifically:

- Amended subdivision (a) to specify the Board shall reimburse the manufacturer of a new motor vehicle for an amount equal to the sales tax “or use tax” which the manufacturer pays to or for the buyer “or lessee” when providing a replacement vehicle or includes in making restitution to the buyer “or lessee” under the Lemon Law;
- Expanded the satisfactory proof that tax was paid, under subdivision (a), to include proof that:
 - “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or
 - “The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of that motor vehicle”; and
- Added subdivision (e) which specifies that “the amount of use tax that the [Board] is required to reimburse the manufacturer shall be limited to the amount of use tax the

manufacturer is required to pay to or for the lessee pursuant to [Civil Code] section 1793.2.”

As a result, Civil Code section 1793.25, subdivision (a), currently provides, in relevant part, that the Board shall reimburse a manufacturer for an amount equal to the sales or use tax which the manufacturer pays to or for a buyer or lessee when providing a replacement vehicle, or includes in making restitution to the buyer or lessee. Also, in order to obtain reimbursement, subdivision (a) currently requires a manufacturer to provide satisfactory proof that it complied with Civil Code subdivision 1793.23, subdivision (c), which pertains to inscribing the ownership certificate of a reacquired vehicle with the notation “Lemon Law Buyback” and affixing a decal to the vehicle regarding the notation on the ownership certificate. And, subdivision (a) requires a manufacture to provide satisfactory proof for one of the following:

- The retailer of the motor vehicle for which the manufacturer is making restitution has reported and paid the sales tax on the gross receipts from the sale of that motor vehicle.
- The buyer of the motor vehicle has paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state.
- The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of that motor vehicle.

Proposed Amendments

Need for Clarification

Subdivision (b)(2) of Regulation 1655, *Returns, Defects and Replacements*, explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement¹ included in restitution paid to a buyer under the Lemon Law. However, there is an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)) because Regulation 1655 does not indicate that AB 242 made amendments to Civil Code sections 1793.2 and 1793.25 to make clear that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or includes in making restitution to a buyer or lessee, under the Lemon Law. Therefore, the Board’s Business Taxes Committee (BTC) staff determined that amendments to Regulation 1655 are needed in order to make Regulation 1655 consistent with and implement, interpret, and make specific the amendments to the Lemon Law made by AB 242 (discussed above).

¹ California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers, as explained in Regulation 1700, *Reimbursement for Sales Tax*.

Interested Parties Process

As a result of AB 242, BTC staff drafted amendments to Regulation 1655. Specifically, the draft amendments suggested adding language to Regulation 1655, subdivision (b)(2)(A) to incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D), by specifying that, for purposes of Regulation 1655, the term buyer includes a lessee of a new motor vehicle. The draft amendments suggested adding “or use” tax to where the current regulation refers to “sales tax or sales tax reimbursement” in subdivision (b)(2)(B) and (C). The draft amendments suggested adding “or lease” after “sales” where the current regulation refers to “sales agreement” and after “sale” where the current regulation refers to “retail sale” in subdivision (b)(2)(B). The draft amendments also suggested adding “or lessor” after “dealer” where the current regulation refers to “the buyer and the dealer” and “the seller’s permit number of the dealer” in subdivision (b)(2)(B).

In addition, the draft amendments suggested revising and reformatting the last sentence in Regulation 1655, subdivision (b)(2)(B), which currently requires a manufacturer, when filing a claim for refund for sales tax or sales tax reimbursement included in restitution paid to a buyer, to submit evidence that the dealer who made the retail sale of the non-conforming motor vehicle to that buyer reported and paid sales tax on the gross receipts from that sale. The revised and reformatted sentence requires a manufacturer, when filing a claim for refund for sales or use tax or sales tax reimbursement included in restitution paid to a buyer, including a lessee, under the Lemon Law, to provide “evidence of one of the following” from a list that includes proof that: (1) “The dealer had reported and paid sales tax on the gross receipts from that sale”; (2) “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or (3) “The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of the vehicle.” The draft amendments also suggested adding a new subdivision (b)(2)(D) to Regulation 1655 to specify that “The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee,” as provided by Civil Code section 1793.25, subdivision (e).

BTC staff subsequently prepared a discussion paper regarding the amendments made to the Lemon Law by AB 242 and staff’s draft amendments to Regulation 1655, provided the discussion paper and its draft amendments to Regulation 1655 to the interested parties, and conducted an interested parties meeting on August 8, 2013, to discuss the draft amendments to Regulation 1655. During the interested parties meeting, a participant inquired as to how the provisions of Regulation 1655 would apply to a transaction in which a lessor paid tax at the time the lessor purchased a vehicle which the lessor would then lease. Staff considered the scenario and, subsequent to the meeting, staff explained to the participant that in the event a lessor purchases a vehicle in this state tax paid, the transaction would generally be subject to sales tax and the dealer would likely collect sales tax reimbursement from the lessor. (See Reg. 1660, subd. (c)(2) and (3), regarding property purchased tax-paid and leased in substantially the same form as acquired.) And, staff explained that, with respect to sales tax transactions, the existing provisions of Regulation 1655 would apply to a manufacturer’s claim for a refund for sales tax reimbursement the manufacturer included in restitution paid to a lessor, under the Lemon Law. Furthermore, staff noted that AB 242 did not change the application of the Lemon Law to sales

tax transactions, and that questions regarding the application of Regulation 1655 to sales tax transactions were beyond the scope of the current interested parties process, which was to discuss the issue of whether to amend Regulation 1655 to clarify the new provisions of the Lemon Law applicable to use tax transactions.

Since BTC staff did not receive any other inquiries or comments regarding the draft amendments during or subsequent to the first interested parties meeting and staff had no changes to its recommendation to amend Regulation 1655, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously scheduled to discuss staff's draft amendments. Staff also notified interested parties that comments could be submitted up to October 17, 2013, for consideration in the preparation of a Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

December 17, 2013 BTC Meeting

Subsequently, staff prepared Formal Issue Paper 13-012 and distributed it to the Board Members for consideration at the Board's December 17, 2013, BTC meeting. Formal Issue Paper 13-012 recommended that the Board approve and authorize publication of the amendments to Regulation 1655 (discussed above) in order to incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle (as provided in Civ. Code, § 1793.2, subd. (d)(2)(D), as added by AB 242).
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund (consistent with Civ. Code, § 1793.25, subd. (a), as amended by AB 242).
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee (as provided in Civ. Code, § 1793.25, subd. (e), as added by AB 242).²

During the December 17, 2013, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1655 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1655 are reasonably necessary for the specific purpose of making the regulation consistent with and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242, and addressing the issue (or problem) that Regulation 1655 does not currently indicate that AB 242 made amendments to Civil Code sections 1793.2 and 1793.25.

The Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing

² The formal issue paper also recommended that the Board approve a minor grammatical change capitalizing the first letter in the word "Board" in Regulation 1655, subdivision (b)(2)(B).

additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The adoption of the proposed amendments to Regulation 1655 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1655 or the proposed amendments to Regulation 1655.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-012, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its December 16, 2013, BTC meeting in deciding to propose the amendments to Regulation 1655 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1655 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1655 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1655 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

Prior to the enactment of AB 242, the Lemon Law expressly provided that a manufacturer was required to make restitution to a buyer in an amount equal to the actual price paid or payable by the buyer, including *sales* tax. The Lemon Law further required the Board to reimburse a manufacturer for an amount equal to the *sales* tax which the manufacturer paid to or for a buyer when providing a replacement vehicle or making restitution. However, the Lemon Law did not expressly address the treatment of *use* tax.

As previously explained in more detail above, AB 242 made specific amendments to Civil Code sections 1793.2 and 1793.25. The amendments clarify that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer, including a lessee, of a new motor vehicle. The amendments also clarify that the Board is required to reimburse a manufacturer of a new motor vehicle for an amount equal to the use tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to California's "Lemon Law." In addition, in order to claim reimbursement for such use tax, the amendments specifically require a manufacturer to provide satisfactory evidence that the buyer paid use tax on the sales price of or the lessee paid use tax on the rentals payable from the lease of the vehicle that the manufacturer replaced or made restitution for. And, the amendments specifically provide that, with regard to leases, the amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee under the Lemon Law.

As previously explained in more detail above, subdivision (b)(2) of Regulation 1655 explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement included in restitution paid to a buyer under the Lemon Law. However, Regulation 1655 does not indicate that AB 242 made amendments to the Lemon Law to clarify that restitution includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution.

Also, as previously explained above, the proposed amendments to Regulation 1655 incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle.
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund.
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee.

As a result, the proposed amendments make Regulation 1655 consistent with the amendments made to the Lemon Law by AB 242, the proposed amendments do not mandate that individuals or businesses do anything that is not already required by the Lemon Law, and there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave, in the absence of the proposed regulatory action, or that would impact revenue. Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact the amendments made to the Lemon Law by AB 242 have had and will have on individuals and businesses. The Board has determined that the proposed amendments to Regulation 1655 are not

a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. And, the Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

In addition, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1655 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1655 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1655 will not affect the benefits of Regulation 1655 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1655 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1655 may affect small businesses.